No. 17-961

In the

Supreme Court of the United States

THEODORE H. FRANK and MELISSA ANN HOLYOAK,

Petitioners,

v.

PALOMAS GAOS, on behalf of herself and all others similarly situated, et al.,

Respondents.

On Writ of Certiorari to the Court of Appeals for the Ninth Circuit

BRIEF OF CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF NEITHER PARTY

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INTEREST OF *AMICUS CURIAE*[1]

The Chamber of Commerce of the United States of America is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million companies and professional organizations of every size, in every industry, from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts.

The Chamber regularly files *amicus curiae* briefs in cases raising issues of concern to the Nation's business community, including cases involving important issues of class-action practice and procedure. Businesses are frequent targets of class-action lawsuits, including abusive suits where cy pres settlements are often used. The Chamber's Institute for Legal Reform has published a white paper that discusses in detail the practical and constitutional concerns raised by the increasing use of cy pres settlements in the class action context. *See* John Beisner et al., *Cy Pres: A Not So Charitable Contribution to Class Action Practice* (2010) ("Beisner"), *available at* http://bit.ly/2zJEFWO. The

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[1] All parties have consented to the filing of this amicus brief. No party's counsel authored this brief in whole or in part; no party or party's counsel contributed money that was intended to fund the preparation or submission of this brief; and no person other than amicus, its members, and its counsel contributed money that was intended to fund the preparation or submission of this brief.

Chamber's interest in these issues reflects its broader interest in ensuring that courts rigorously and properly enforce the requirements of Rule 23 and Article III of the Constitution of the United States.

INTRODUCTION AND SUMMARY OF ARGUMENT

Both the petitioners and the defendant below recognize that cy pres settlements in the class-action context raise serious concerns and require close judicial scrutiny. The parties dispute whether the particular cy pres settlement reached in this case is appropriate notwithstanding those concerns. But on that issue the Chamber takes no position.

Instead, the Chamber is submitting this brief in support of neither party to urge the Court that the first solution to the concerns raised by cy pres settlements is to police rigorously the requirements for class certification at the front end. More fundamentally, the Chamber seeks to highlight that the explosion of cy pres settlements in class-action litigation is symptomatic of a much deeper problem—the failure of lower courts to comply with this Court's precedents and rigorously police the requirements of Rule 23.

In a line of important decisions, this Court has emphasized that class actions are supposed to be the exception to the general rule that litigation should be pursued on an individual basis. It has held that a class should not be certified if absent class members have not suffered a concrete injury-in-fact. It has rejected class actions that would strip defendants of their rights to litigate every available defense. And it

has recognized the extraordinary settlement pressures that defendants face even in meritless cases when confronted with potentially massive class-action liability, emphasizing that courts must perform a rigorous analysis at the outset of a case to determine whether Rule 23's exacting requirements are satisfied.

But there is a yawning gap between this Court's class-action precedents and how the lower courts have applied those precedents in practice. The unfortunate reality is that lower courts in plaintiff-friendly venues are routinely failing to apply the law. Many courts view the class-action device as an expedient for clearing cases from their dockets, recognizing that placing a heavy thumb on the scale in favor of class certification will often prompt settlement. As a result, courts often certify a class no matter how negligible class members' alleged injuries may be and with no concern for defendants' individualized defenses. Outside of the most egregious cases, courts are unwilling to discipline class-action abuse and, as a result, every potential misstep or regulatory violation, no matter how insignificant or how inventive a theory of liability may be required to plead a claim, becomes another opening for enterprising class counsel. Even defendants who are inclined to vigorously defend these cases are placed in an untenable position. Because courts that take a lenient approach to class actions rarely impose reasonable limits on the award of class counsel fees, the harder a defendant fights in its defense, the more it can ultimately expect to pay out in settlement. The result is that every year American business are forced to defend and settle

thousands of meritless class actions that benefit no one except class counsel.

In light of these trends, it may be unsurprising that defendants have more frequently resorted to cy pres settlements. Whatever one thinks of cy pres settlements as a matter of first principle, they have become an unfortunate safety valve—a way for defendants to manage their exposure to meritless cases filed in venues where courts are unwilling to enforce Rule 23. Indeed, the resort to a cy pres settlement is almost inevitably a sign that the underlying class claims are of dubious merit. Here, for instance, the defendant reasonably elected to negotiate an early end to weak and meritless claims brought by class counsel given the notorious challenges and expense of defending against class actions in courts within the Ninth Circuit.

However this Court views the appropriateness of the settlement negotiated in this case, there is an urgent need for it to take this opportunity to reiterate—clearly, forcefully, and unequivocally—the essential principles of class-action law that it has previously articulated and signal to the lower courts its commitment to ensuring that they are properly enforced. Unless the Court takes this crucial step, any guidance it provides on the use of cy pres settlements may be of only limited value—a temporary balm that may ameliorate a troubling symptom, but does little to address the underlying cause of the serious and growing class-action abuse that infects our nation's legal system.

ARGUMENT

I. The Best Way To Police Cy Pres Settlements Is At The Front End, By Denying Certification Of Unmanageable Classes.

Cy pres settlements of class action lawsuits have significantly increased in the past two decades. *See* Martin H. Redish et al., *Cy Pres Relief and the Pathologies of the Modern Class Action: A Normative and Empirical Analysis*, 62 Fla. L. Rev. 617, 653 (2010) ("Redish"). This growth is a direct consequence of lower courts' refusal to police compliance with Rule 23's essential requirements. *See In re Agent Orange Prod. Liab. Litig.*, 818 F.2d 179, 185 (2d Cir. 1987) ("[U]nwarranted relaxation of the manageability requirements [of Rule 23] . . . induce[s] plaintiffs to pursue 'doubtful' class claims for 'astronomical amounts' and thereby 'generate . . . leverage and pressure on defendants to settle.'") (last alteration in original) (quoting *Eisen v. Carlisle & Jacquelin*, 479 F.2d 1005, 1019 (2d Cir. 1973), *vacated on other grounds*, 417 U.S. 156 (1974)).

The most powerful tool for limiting the growth of cy pres settlements is strict adherence to Rule 23 and this Court's class-action precedents. Unfortunately, many lower courts continue to disregard this Court's instructions, treating them as at best hortatory—principles to be dutifully recited but rarely applied to curtail class-action abuse in any meaningful fashion. Because the Court has granted certiorari to address the problems of cy pres settlements, it should take this opportunity to reiterate the basic principles that are supposed to govern the lower courts'

consideration of class certifications motions under Rule 23.

A. Lower Courts Continue To Certify Classes Where Some Or All Of The Absent Class Members Suffered No Actual Injury.

Emblematic of lower courts' refusal to apply Rule 23 correctly is the growing prevalence of "no-injury" class action settlements, circumventing the bedrock requirements of Article III and Rule 23. That no-injury class actions run counter to Article III standing should be obvious: A Rule 23 class action is nothing more than the sum of the individual class members' claims. Packaging claims in a class vehicle does not enlarge the power of federal courts to hear claims they would not otherwise have jurisdiction to hear. As the Chief Justice recently noted, "Article III does not give federal courts the power to order relief to *any* uninjured plaintiff, *class action or not*." *Tyson Foods, Inc. v. Bouaphakeo*, 136 S. Ct. 1036, 1053 (2016) (Roberts, C.J., concurring) (emphases added).

These lawsuits also raise serious due process concerns, because there is little incentive for unnamed class members to monitor and participate in litigation where they have sustained or will sustain no actual damages. Due process requires that the class representative "fairly insures the protection of the interests of absent parties who are to be bound by" the outcome of the litigation. *Hansberry v. Lee*, 311 U.S. 32, 42 (1940). In turn, absent class members must receive adequate notice and an opportunity to be heard and participate in the class proceedings. *See Phillips Petrol. Co. v. Shutts*,

472 U.S. 797, 811-12 (1985). The adequate representation requirement "serves to uncover conflicts of interest between named parties and the class they seek to represent." *Amchem Prods., Inc. v. Windsor*, 521 U.S. 591, 625 (1997).

In a no-injury class action, however, the class representatives—to say nothing of absent class members—have little incentive to monitor the litigation and hold their class counsel accountable, since they "have individually too little at stake to spend time monitoring the lawyer—and their only coordination is through" counsel. *Mars Steel Corp. v. Cont'l Ill. Nat'l Bank & Tr. Co. of Chi.*, 834 F.2d 677, 681 (7th Cir. 1987). The practical result is that "class counsel effectively appoint themselves as agents for the class, wielding a power to transact in class members' rights." Richard A. Nagareda, *The Preexistence Principle and the Structure of the Class Action*, 103 Colum. L. Rev. 149, 150-51 (2003). And class members can have "their future claims devalued and decided before they even accrue," long before it is "obvious that the settling of future plaintiffs' claims—essentially without their knowledge—is desirable, necessary, or worthwhile." Jeremy Gaston, *Standing on Its Head: The Problem of Future Claimants in Mass Tort Class Actions*, 77 Tex. L. Rev. 215, 237-38 (1998).

Despite these fundamental due process concerns, lower courts have disregarded this Court's directive that a class plaintiff must suffer harm that "actually exist[s]" and is not "'abstract.'" *Spokeo, Inc. v. Robins*, 136 S. Ct. 1540, 1548 (2016). For example, the Ninth Circuit recently held that a class

representative had standing to seek injunctive relief under California consumer protection law because she had purchased flushable wipes with an allegedly false or misleading label, since they were not "flushable" according to her standards. The disgruntled consumer threw the wipes away and vowed never to purchase them again. *See Davidson v. Kimberly-Clark Corp.*, 889 F.3d 956, 966-67 (9th Cir. 2018). Although there was no possibility that the plaintiff would ever be injured by the allegedly false label because *by her own admission* she would never purchase the product again, the Ninth Circuit found that she had standing to pursue injunctive relief for the class. Rather than dismissing the case for lack of jurisdiction, the Ninth Circuit concluded that the class claims could be litigated because the plaintiff "will be unable to rely on the product's advertising or labeling in the future, and so will not purchase the product although she would like to," or "might purchase the product in the future, despite the fact it was once marred by false advertising or labeling, as she may reasonably, but incorrectly, assume the product was improved." *Id.* at 969-70. This holding—replete with "mights" and "mays"—runs directly contrary to this Court's express statement that mere "'[p]ast exposure to illegal conduct does not in itself show a present case or controversy regarding injunctive relief,'" *City of Los Angeles v. Lyons*, 461 U.S. 95, 102 (1983) (alteration in original) (citation omitted), and that to demonstrate standing a plaintiff must show that she is "realistically threatened by a repetition" of past wrongful conduct, *id.* at 109; *see also Friends of the Earth, Inc. v. Laidlaw Envtl. Servs. (TOC), Inc.*, 528

U.S. 167, 180-81 (2000) (to maintain a claim for forward-looking relief, plaintiff must show that she faces an "actual or imminent," not "conjectural or hypothetical" harms).

Davidson is a recent example of lower courts bending the rules of standing and Rule 23 to save specious class allegations in no-injury cases. But it is not the only one. The Third Circuit recently held that a class had Article III standing to bring suit against an eye-drop manufacturer because the dropper dispensed the fluid in a way that caused some of it to roll out of the user's eye. *See Cottrell v. Alcon Labs.*, 874 F.3d 154, 159 (3d Cir. 2017), *cert. denied*, 138 S. Ct. 2029 (2018). Plaintiffs alleged they were injured financially because manufacturers did not use alternative, supposedly more efficient product packaging that would have enabled them to get more doses from the same volume of medicine. The district court denied certification, holding that the putative class did not meet the rigorous requirements of Rule 23, because there was no concrete allegation that the product packaging change would have resulted in lower prices. *Id.* at 161, 168. The Third Circuit reversed, holding that plaintiffs had shown a concrete and particularized injury by alleging that they "would have paid less for their course of medication if they were able to extract more doses of medication . . . out of the same bottle." *Id.* at 168. But plaintiffs presented no concrete allegation that the manufacturers priced their medicine based on the volume of fluid in the bottle and not the number of doses the bottle contained, or that manufacturers would have passed marginal cost savings on to consumers instead of pocketing them.

Similarly, a district court in Wisconsin certified a class and approved a settlement where plaintiffs alleged that the fast food restaurant Subway was defrauding consumers by selling "Footlong" sandwiches that were sometimes slightly shorter than twelve inches. *See In re Subway Footlong Sandwich Mktg. & Sales Practices Litig.*, 869 F.3d 551, 553 (7th Cir. 2017). There, the district court found that the plaintiff class had standing to pursue injunctive relief, despite it being undisputed that the sandwiches rarely fell short of twelve inches, and even when they did, the variations were due to natural variability in the baking process—the unbaked bread sticks were uniform, so all customers received the same amount of food. *Id.* at 554. The settlement provided no monetary recovery, only injunctive relief by which Subway bound itself to implement new measuring tools and a beefed-up inspection regime, but the settlement also explicitly acknowledged that Subway "'will never be able to guarantee that each loaf of bread will always be exactly 12 inches or greater in length after baking.'" *Id.* at 556-57 (quoting the settlement). After hearing from the same settlement objector that is petitioner in this case, the Seventh Circuit reversed, calling the injunctive relief "'worthless'" and holding that the district court improperly certified a "'settlement that yields zero benefits for the class'" in a case where "[p]roof of injury was nigh impossible." *Id.* at 554, 556 (citation omitted). "The settlement enriches only class counsel and, to a lesser degree, the class representatives." *Id.* at 557.

What is troubling about these examples is that the Seventh Circuit's decision appears to be a rare

outlier in a much broader trend of abusive class-action litigation that courts are unwilling to police. Lower courts all too often treat class certification as an easy threshold to satisfy in any litigation involving businesses and consumers, leaving business defendants with no reasonable option except to seek settlement or else find themselves confronting large legal bills and facing potential disastrous liability for even the most meritless claims.

B. Lower Courts Continue To Circumvent The Commonality And Predominance Requirements.

Courts also promote cy pres settlements by certifying classes that do not satisfy the threshold requirement that "questions of law or fact common to class members predominate over any questions affecting only individual members." Fed. R. Civ. P. 23(b)(3). This inquiry requires courts to "conduct a 'rigorous analysis' to determine whether" plaintiffs have carried that burden, "even when that requires inquiry into the merits of the claim." *Comcast Corp. v. Behrend*, 569 U.S. 27, 35 (2013) (quoting *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 351 (2011)). Class-action plaintiffs must offer "a theory of liability that is . . . capable of classwide proof." *Id.* at 37-38. It is not enough that a class propose "*any* method[ology] . . . so long as it can be applied classwide." *Id.* at 35-36. Nor can the answers generated by that methodology be "arbitrary" or "'speculative.'" *Id.*

Despite this Court's clear admonitions, courts continue to certify classes even though "the validity

of each one of the claims" cannot be resolved "in one stroke." *Dukes*, 564 U.S. at 350. For example, the Sixth and Seventh Circuits allowed plaintiffs to circumvent the strict commonality requirement set forth in *Dukes* by certifying classes of consumers who bought certain washing machines, even though it was admitted that very few of the purchasers experienced any actual problems. *See Butler v. Sears, Roebuck & Co.*, 702 F.3d 359, 362 (7th Cir. 2012), *judgment vacated*, 569 U.S. 1015 (2013), *on remand, reinstated*, 727 F.3d 796, 802 (7th Cir. 2013); *In re Whirlpool Corp. Front-Loading Washer Prods. Liab. Litig.*, 678 F.3d 409, 414 (6th Cir. 2012), *cert. granted, judgment vacated, sub nom, Whirlpool Corp. v. Glazer*, 569 U.S. 901 (2013), *aff'd*, 722 F.3d 838 (6th Cir. 2013). In those cases, consumers sued washing machine manufacturers based on an alleged design defect that resulted in mold. When both classes were certified, the manufacturers appealed, arguing that the classes were overbroad as it was undisputed that most of the consumers experienced no problems with their washing machines and the consumers had all purchased different models and configurations. *See Butler*, 702 F.3d at 361-62; *Whirlpool*, 678 F.3d at 418, 420. Both circuits affirmed. The Sixth Circuit held that certification is appropriate "'if class members complain of a pattern or practice that is generally applicable to the class as a whole,'" even if application of this theory means that the class would include many uninjured plaintiffs. *Whirlpool*, 678 F.3d at 420 (citation omitted).

This Court remanded the decisions to the Sixth and Seven Circuits to consider in light of *Comcast*

and *Dukes*. *See Sears, Roebuck & Co. v. Butler*, 569 U.S. 1015 (2013); *Whirlpool Corp. v. Glazer*, 569 U.S. 901 (2013). Both the Sixth and Seventh Circuits affirmed their earlier rulings, based on a supposedly common question of whether the machines had a propensity to cause mold, even though, as the Sixth Circuit noted, it was undisputed that the machines "were built over a period of years on two different platforms, resulting in the production of twenty-one different models during the relevant time frame." *Whirlpool*, 722 F.3d at 854; *see also Butler*, 727 F.3d at 798 (approving class certification even though the manufacturer "made a number of design modifications, and as a result different models are differently defective").

The failure to adequately police the commonality requirement has a direct connection to the rise of cy pres settlements. One of the factors courts are supposed to consider in determining whether commonality exists is "the likely difficulties in managing a class action." Fed. R. Civ. P. 23(b)(3)(D). Cy pres settlements are often resorted to when the normal means of providing "compensation of individual victims . . . through use of the class action device is [thought] infeasible," because directly compensating the class is not manageable. Redish, *supra*, 62 Fla. L. Rev. at 639-40. But the proper course for a district court confronted by an unmanageable class is not to find some "next best" alternative. Instead, it should decline to certify the class on the ground that "resort to the class action procedure is improper." *Id.* at 640.

C. Lower Courts Increasingly Permit The Use Of Unrebuttable Presumptions Of Injury.

The requisite "rigorous analysis" of putative classes has also been frustrated by the lower courts' practice of employing presumptions that class members have been injured. *See Waggoner v. Barclays PLC*, 875 F.3d 79, 106 (2d Cir. 2017), *cert. denied*, 138 S. Ct. 1702 (2018); *Kleen Prods. LLC v. Int'l Paper Co.*, 831 F.3d 919, 931 (7th Cir. 2016), *cert. denied*, 137 S. Ct. 1582 (2017).

Because "actual, *not presumed*, conformance" with Rule 23's requirements is "indispensable," *Gen. Tel. Co. of S.W. v. Falcon*, 457 U.S. 147, 160 (1982) (emphasis added), plaintiffs are supposed to have the burden to "'affirmatively demonstrate'" their compliance with Rule 23. *Comcast*, 569 U.S. at 33 (quoting *Dukes*, 564 U.S. at 350). In light of these stringent requirements, this Court has applied presumptions in the class action context only in very limited circumstances, where the market to which the presumption is applied is one that is "impersonal, well-developed," and "information-hungry," meaning that the presumption is "supported by common sense and probability." *Basic Inc. v. Levinson*, 485 U.S. 224, 245-47, 249 n.29 (1988).

Lower courts have nonetheless expanded the use of these presumptions of injury to markets that are not impersonal, well-developed, and information-hungry. For example, in *Waggoner*, the Second Circuit allowed a class suing under Rule 10b-5 to rely on a presumption of injury to establish an element of its claim, despite the fact that the econometric model

used could not disaggregate whether declines in stock prices were caused by defendant's alleged conduct or state regulatory action. 875 F.3d at 106. The court also disregarded evidence that the defendant put forth to rebut the showing of market efficiency, holding that defendants must meet a burden of persuasion rebutting the presumption even though the burden on class certification rests with plaintiffs. *Id.* at 101-03.

Similarly, in *Kleen Products*, the Seventh Circuit approved a presumption of class-wide injury based on price increases in an unrepresentative price index. 831 F.3d at 927. The court ignored evidence demonstrating that the index price did not reflect the prices that individual plaintiffs actually paid, which were driven by a variety of non-price inputs and were often individually negotiated. *Id.* at 927-29. The presumption was thus treated as essentially irrebuttable, further lowering the threshold of what putative classes need to prove to meet the requirements of Rule 23.

Lower courts' increased willingness to depart from this Court's statements about care in the use of presumptions to demonstrate injury threatens to invite even more meritless class actions, which, in turn, will inevitably yield more cy pres settlements.

II. Cy Pres Settlements Should Be Subject To Close Scrutiny.

The best solution to the problems presented by cy pres settlements is for lower courts to enforce the requirements of Rule 23 at the front end—and thus to relieve the pressure for opportunistic cy pres

settlements at the back end. But where plaintiffs establish Article III standing and a class is properly certified, cy pres settlements may serve as a safety valve for defendants facing costly and burdensome class-action litigation and, thus, tremendous pressures to settle, even where they have meritorious defenses and the class allegations are specious. Cy pres settlements may enable defendants to end meritless class actions quickly and allow defendants to avoid the risks and burdens of abusive litigation.

Nonetheless, cy pres settlements may present serious ethical quandaries. For example, class counsel often prefer cy pres settlements, as they allow counsel to puff up their overall "recovery" in cases where class members have suffered at best only nominal injuries. Similarly, both class counsel and the court may value the reputational benefits that arise when cy pres settlements shower favored schools and charities with windfall distributions. Given these conflicting incentives, there is a serious risk that cy pres settlements may prejudice the rights of absent class members. That risk can be managed only by ensuring that certain features of cy pres settlements are subject to exacting scrutiny.

A. Cy Pres Settlements Are A Response To Meritless But Costly Class Actions.

Even apart from the risks of potential massive damages liability, the cost of defending class actions can be substantial, putting enormous pressures on defendants to settle even specious class actions. These cases can drag on for years even before the court takes up the question of class certification. *See* U.S. Chamber Institute for Legal Reform, *Do Class*

Actions Benefit Class Members? An Empirical Analysis of Class Actions, at 1, 5 (Dec. 2013), *available at* http://bit.ly/2upAR80. ("Approximately 14% of all class action cases remained pending four years after they were filed, without resolution or even a determination of whether the case could go forward on a class-wide basis."). Indeed, the cost to defend a single large class action can run as much as $100 million. *See* Adeola Adele, *Dukes v. Wal-Mart: Implications for Employment Practices Liability Insurance* 1 (July 2011). Class-action litigation costs in the United States totaled a staggering $2.24 billion in 2017, continuing a rising trend that started in 2015. *See The 2018 Carlton Fields Class Action Survey*, at 2 (2018) ("Class Action Survey"), *available at* http://bit.ly/2upBY7G.

Given the potentially enormous costs of defending against even a meritless class action, a business defendant will often choose to settle instead of rolling the dice on further litigation, even if it expects to (and under the law should) prevail on summary judgment or at trial. This Court has long recognized the power of class-action lawsuits to induce settlement. *See AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 350 (2011) (noting "the risk of 'in terrorem' settlements that class actions entail"); *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 559 U.S. 393, 445 n.3 (2010) (Ginsburg, J., dissenting) (quoting Advisory Committee's Notes on Fed. R. Civ. P. 23) ("[A] class action can result in 'potentially ruinous liability.'")). As the Court noted 40 years ago, "[c]ertification of a large class may so increase the defendant's potential damages liability and litigation costs that he may

find it economically prudent to settle and to abandon a meritorious defense." *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 476 (1978).

The pressures today are even greater than they were then. In 2017, companies reported settling 71 percent of class actions, up from 63 percent the year before. *See* Class Action Survey, *supra*, at 26. Just 4 percent of class actions go to trial, and most cases settle before a class is even certified—a reflection of the power of certification to extract settlement. *Id.*

In this litigation environment, the benefits of settling class-action lawsuits has given rise to an increased use of cy pres settlements. They have become one of the only ways for defendants to compromise and escape the burdens of meritless and costly class-action litigation, especially in venues where courts have been unwilling to apply the rigorous scrutiny to class certification that Rule 23 requires.

B. Conflicts Between Class Counsel And The Absent Class Are Inherent In Cy Pres Settlements.

This Court has long recognized that Rule 23's requirements protect the rights of both defendants and absent class members, by ensuring that the procedures for aggregating claims and streamlining litigation are employed only in appropriate circumstances. *See Taylor v. Sturgell*, 553 U.S. 880, 900–01 (2008). One of those procedural protections is Rule 23(e)'s fairness inquiry, which "protects unnamed class members 'from unjust or unfair settlements affecting their rights.'" *Amchem*, 521

U.S. at 623 (quoting 7B Wright, Miller, & Kane § 1797, at 340–41); *see also Hansberry*, 311 U.S. at 42 (courts must "fairly insure[] the protection of the interests of absent parties").

Any class action settlement may present ethical quandaries, as class counsel have an incentive to negotiate a recovery that prompts settlement while maximizing their fee award. *See Eubank v. Pella Corp.*, 753 F.3d 718, 720 (7th Cir. 2014) ("From the selfish standpoint of class counsel and the defendant, . . . the optimal settlement is one modest in overall amount but heavily tilted toward attorneys' fees."); *In re Dry Max Pampers Litig.*, 724 F.3d 713, 715 (6th Cir. 2013) ("there is always the danger that the parties and counsel will bargain away the interests of unnamed class members in order to maximize their own"). One structural safeguard that is supposed to counteract that incentive is class counsel's duty of loyalty "'to absent class members whose control over their attorneys is limited.'" *Rodriguez v. Disner*, 688 F.3d 645, 655 (9th Cir. 2012) (citation omitted). With their individual claim turned over to the class representative, absent class members must rely on the good faith of class counsel to obtain fair recompense for their injuries. In short, "the law relies upon the 'fiduciary obligation[s]' of the class representatives and, especially, class counsel, to protect those interests." *Dry Max Pampers Litig.*, 724 F.3d at 718 (alteration in original) (citation omitted).

Class counsel have struggled to toe this line in many settlement contexts. *See* John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class*

Action, 95 Colum. L. Rev. 1343, 1347-48 (1995) (noting that "non-adversarial settlements have all too frequently advanced only the interests of plaintiffs' attorneys, not those of the class members"). But cy pres settlements in particular can strain the duty of loyalty to a breaking point. "By disincentivizing class attorneys from vigorously pursuing individualized compensation for absent class members, cy pres threatens the due process rights of those class members." Redish, *supra*, 62 Fla. L. Rev. at 650. Cy pres awards drive a wedge between class counsels' interest in a generous fee award and the amount recovered by individual class members. Class counsel are thus able to "reap exorbitant fees regardless of whether the absent class members are adequately compensated." Beisner, *supra*, at 13. As courts have noted, decoupling the financial incentives of class counsel and absent class members creates potential conflicts of interest, for "[c]lass members are not indifferent to whether funds are distributed to them or to *cy pres* recipients, and class counsel should not be either." *In re Baby Prods. Antitrust Litig.*, 708 F.3d 163, 178 (3d Cir. 2013).

The result of this inherent conflict has been the creation of what one commentator has called the "cy pres industry," an unseemly scramble to be first in line when cy pres funds are disbursed. Sam Yospe, *Cy Pres Distributions in Class Action Settlements*, 2009 Colum. Bus. L. Rev. 1014, 1035 (2009). State and local bar associations, for example, have published manuals encouraging members to steer cy pres funds to their legal services departments. *Id.* at 1035-36. Law school clinics have appeared at settlement hearings and "requested that a portion of

the unexpended funds be set aside to fund their clinics." *SEC v. Bear, Stearns & Co. Inc.*, 626 F. Supp. 2d 402, 409 (S.D.N.Y. 2009). And class counsel have not neglected the opportunity to use cy pres settlement funds—supposedly provided to recompense injured class members—as pots of money for dispensing gifts to favored causes. *See* Pet. Br. at 29-30 (recounting instances where cy pres funds went to non-profit and educational organizations affiliated with class counsel); *see also Bear Stearns*, 626 F. Supp. 2d at 414–15 (collecting cases where cy pres awards in class action settlements "stray[ed] far from the 'next best use'").

Unfortunately, some courts have embraced their newfound role as public charities, taking on duties normally associated with foundation grant officers. *See Fears v. Wilhelmina Model Agency, Inc.*, No. 02 Civ. 4911(HB), 2007 WL 1944343, at *11 (S.D.N.Y. July 5, 2007) ("After the initial distribution, additional distributions will be contingent upon achievement. Each entity will provide the Court in an annual report with information detailing what the project has accomplished."), *vacated*, 315 F. App'x 333 (2d Cir. 2009). While oversight of the distribution of cy pres funds is necessary, this grantmaking role can place "judges in ethically compromising situations . . . [i]ntroducing cy pres into the adjudicatory process transforms supposedly impartial decision makers into grant supervisors." Jennifer Johnston, *Cy Pres Comme Possible to Anything is Possible: How Cy Pres Creates Improper Incentives in Class Action Settlements*, 9 J. L. Econ. & Pol'y 277, 287–88 (2013). In fact, in some cases, courts have used cy pres funds to benefit their own

preferred charities. *See In re Google Buzz Privacy Litig.*, No. C 10-00672 JW, 2011 WL 7460099, at *1 (N.D. Cal. June 2, 2011) (district court *sua sponte* "nominat[ing] the Markkula Center for Applied Ethics at Santa Clara University," where the district judge taught, for a cy pres distribution); *Perkins v. Am. Nat'l Ins. Co.*, No. 3:05-CV-100 (CDL), 2012 WL 2839788, at *1 (M.D. Ga. July 10, 2012) (approving cy pres award to the presiding judge's *alma mater*).

C. Cy Pres Settlements Should Be Subject To Strict Standards.

Federal court reviews of proposed class settlements for fairness under Rule 23(e) are not intended to be "appraisals of the chancellor's foot kind—class certifications dependent upon the court's gestalt judgment or overarching impression of the settlement's fairness." *Amchem*, 521 U.S. at 621.

The Chamber therefore urges the Court to impose strict standards on the use of cy pres settlements. These standards are consistent with Rule 23(e) and a district court's "special duty to act as guardian for the interests of absent class members," which arises because "they are not present but will be bound by the disposition of the case." 2 *McLaughlin on Class Actions* § 6:4 (14th ed. 2017).

Cy pres distributions should not be approved if it is feasible to reliably identify and then distribute funds to absent class members. The Seventh Circuit has held that cy pres distributions should not be approved if economically feasible means of identifying class members and

compensating them remain. *See Pearson v. NBTY, Inc.*, 772 F.3d 778, 784 (7th Cir. 2014). The Court should adopt this rule. In *Pearson*, the court noted that "the claims process could have been simplified" to increase the response rate, or the defendant could "have mailed [settlement fund distributions] to all" consumers that it knew had purchased its product. *Id.* Cy pres distributions of the unexpended settlement funds should be considered only when those funds "can't feasibly be awarded to the intended beneficiaries," because the administrative or other costs of finding class members and making distributions to them are disproportionately high. *Id.*

Where absent class members can be identified, the simplest solution to the problem of undistributed settlement funds—the one adopted by the Eighth and Fifth Circuits—is to make additional distributions to identified class members, unless the court determines that their claims have been fully satisfied. "Because the settlement funds are the property of the class, a *cy pres* distribution to a third party of unclaimed settlement funds is permissible 'only when it is not feasible to make further distributions to class members.'" *Klier v. Elf Atochem N. Am., Inc.*, 658 F.3d 468, 475 (5th Cir. 2011) (citation omitted). Where class members have already been identified and fully compensated, there is no need to divert settlement funds to third parties; the court should order the funds returned to the defendant. *Id.* at 482. ("The preferable alternative . . . is to return any excess funds to the defendant."); *see also In re BankAmerica Corp. Sec. Litig.*, 775 F.3d 1060, 1064 (8th Cir. 2015) (where "class members who received and cashed prior distribution checks

exist and would form the basis of a further distribution to the classes," it was an abuse of discretion to order cy pres distribution to third party).

If cy pres distributions are warranted, courts must carefully scrutinize conflicts of interest and "next best use." In limited circumstances, cy pres distributions may be warranted, but only when it is not "logistically feasible and economically viable" to make further distributions because the amounts to be distributed are too small. *Klier*, 658 F.3d at 475. But in that instance, the court must ensure that the settlement funds have been put "to their next-best use by providing an indirect benefit to the class." *Id.* Cy pres distributions should be made "for a purpose as near as possible to the legitimate objectives underlying the lawsuit, the interests of class members, and the interests of those similarly situated." *In re Airline Ticket Comm'n Antitrust Litig.*, 307 F.3d 679, 682 (8th Cir. 2002). And the court must be especially vigilant to surface conflicts of interest that might raise a reasonable inference that third parties have been selected for improper reasons.

Cy pres distributions should not be considered in determining fee awards. In determining a fee award for class counsel, "[o]ne fundamental focus is the result *actually achieved for class members* . . . [even for] a percentage approach to fee measurement." Rule 23(h) Advisory Committee Comments to 2003 Amendments (emphasis added). Through cy pres awards, class

counsel are able to inflate the "recovery" to the class and "reap exorbitant fees regardless of whether the absent class members are adequately compensated." Beisner, *supra*, at 13. But a distribution of settlement funds to third parties is not a result "actually achieved" for class members. *See Mirfasihi v. Fleet Mortg. Corp.*, 356 F.3d 781, 784 (7th Cir. 2004) ("There is no indirect benefit to the class from the defendant's giving the money to someone else."). There is no justification for awarding fees to class counsel on the basis of cy pres distributions that achieve no more than an indirect benefit for the class members whose claims, in the aggregate, created the settlement fund in the first place. As a result, disregarding cy pres distributions when considering fee awards is the only way to align class counsel's financial incentives with its duty of loyalty to the absent class. *See Pearson*, 772 F.3d at 781 (disapproving fee award based on $20.2 million settlement fund where actual distributions to the class totaled "a meager $865,284").

* * *

No matter what the Court decides with respect to this particular settlement, the overall significance of this case will depend on whether the Court is willing to exercise its authority to discipline the lower courts and require compliance with its precedents on class certification. At a minimum, the Court should make clear that district courts are required to scrutinize proposed cy pres settlements at the front end by rigorously applying this Court's decisions to deny certification of specious class actions. And for those class actions that do make it

through that initial screen, district courts should police the distribution of class-settlement amounts at the back end to ensure that payments are fair and free of conflicts of interest. Above all, the Court should emphasize the importance of lower courts' abiding by this Court's precedents on class action certification.

CONCLUSION

The Chamber takes no position on whether the judgment below should be affirmed, but urges the Court to reaffirm the important procedural protections that are essential to preventing abuse of the class-action device by the plaintiffs' bar.

Respectfully submitted,

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